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Global Asset Allocation: The View From Europe

November 2023

1 Market Perspective

- Global central banks' emphasis is moving towards growth stabilisation with increasing evidence that both growth and inflation are trending lower.
- European and UK economic growth is nearing recession levels, putting central banks on hold, while the US economy remains resilient, supported by a strong consumer. China seeks to stabilise weakening growth through increased policy support.
- While global central bank tightening has likely peaked, the US Fed's pledge for 'higher for longer' rates has had worldwide impact on raising longer-term yields that could create vulnerabilities.
- Key risks to global markets include impacts of the sharp move higher in rates, a deeper-than-expected decline in growth, central bank missteps, a reacceleration in inflation, the trajectory of Chinese growth and geopolitical tensions.

2 Portfolio Positioning

As of 31 October 2023

- We closed our underweight to equities and are now neutral, taking advantage of recent declines amid the rise in yields. The declining inflation trend amid still stable growth is supportive for the end of the Fed tightening cycle, while equity valuations beyond narrow leadership are attractive. We remain overweight areas of the market with supportive valuations, such as small-caps and Japan.
- We remain underweight Europe because of its vulnerability to slowing economic growth, on the one hand, and the European Central Bank that still needs to keep policy tight to fight inflation, on the other hand.
- Within fixed income, we closed our overweight to cash relative to bonds. While cash provides attractive yields, we took advantage of a recent rise in government bonds yields to reduce our underweight to the asset class, with the expectation of some reversal in the trajectory of yields.
- Within fixed income higher-yielding sectors, we remain overweight high yield and emerging market bonds on still attractive absolute yield levels and reasonably supportive fundamentals.

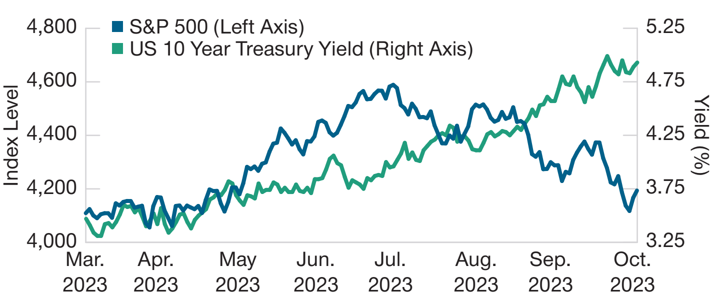
3 Market Themes

Goldilocks

Earlier this year, positive economic data were welcomed as it meant that the US economy could possibly be skirting past an inevitable hard landing. Now similar good news is seemingly too hot for the markets, raising concerns that the Fed may keep its foot on the brakes for longer. Surprisingly strong third-quarter growth of over 5%, a still tight labour market and unrelenting US consumer spending are all helping fuel the Fed's 'higher for longer' narrative. In reaction, bond yields have spiked to decade-high levels, tightening financial conditions and, in a way, helping advance the Fed's cause. Since the end of July, equity markets have declined over 10%, largely driven by the sharp rise in yields and anticipated impacts should they stay at these levels for longer. For now, too hot data seem unwelcome, and too cold is likely to reignite fears of a hard landing. A good balance of declining inflation and not collapsing growth data ahead may prove just right for investors' appetites.

Equities Feeling Sharp Rise in US 10-Year Treasuries

As of 31 October 2023

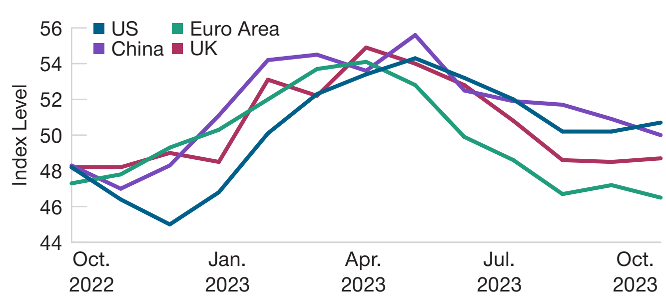


Collateral Damage

While the US economy continues to show resilience in the face of higher interest rates, growth across many parts of the world is showing signs of weakness. Europe looks to have slipped into recession, the UK is not far behind and Chinese growth has disappointed. The emphasis on fighting inflation is steadily being replaced by the need to stabilise declining growth, at least outside the US. Unfortunately, for the rest of the world, the US Fed's policy has far-reaching impacts as seen by the recent spike in longer-term yields globally. With many regions seeing weakening growth, higher yields may not be a welcome sign as global central banks are starting to downshift interest rate policies. The move higher in yields has also sent the US dollar even higher, proving especially painful for many emerging markets economies, their currencies and dollar-denominated bond markets. Should the rest of the world continue to slow while the Fed keeps rates elevated, more collateral damage may be in store for vulnerable economies needing to stabilise growth, defend currencies and compete for capital flows.

Divergence in Purchasing Managers' Indices as Global Growth Slows

As of 31 October 2023



Past performance is not a reliable indicator of future performance.

Each country/region is represented by its respective S&P Global Composite Purchasing Managers' Indices: US: S&P Global Composite United States; China: S&P Global Composite China; Euro Area: S&P Global Composite Euro Area; UK: S&P Global Composite United Kingdom. See Additional Disclosures.

Source: Bloomberg Finance L.P.

REGIONAL BACKDROP

Europe — U

Positives
- Inflation is cooling faster than expected
- European Central Bank (ECB) may be finished hiking
- Labour market has been resilient

Negatives
- Inflation remains elevated, particularly core inflation
- Economic growth is slowing
- Monetary policy is restrictive

United Kingdom — N

Positives
- Still high inflation has begun to moderate
- Bank of England (BoE) may be finished hiking
- Labour market remains strong

Negatives
- The BoE may be forced to keep rates elevated
- Fiscal consolidation may need to be accelerated
- Tight labour markets could keep wage inflation elevated

United States — O

Positives
- Consumer spending remains strong
- Labour market has been resilient
- Fiscal spending has supported capex
- Earnings expectations are increasing

Negatives
- Monetary policy remains very tight
- Banking sector concerns will impact credit availability
- Interest rates are expected to remain elevated

Japan — O

Positives
- Economy benefitting from uptick in inflation
- Corporate governance continues to gradually improve
- Equity valuations remain attractive

Negatives
- Yen weakness has weighed on equity market returns
- Earnings expectations may need to be revised lower

Asia Pacific ex-Japan — N

Positives
- China economic activity is incrementally improving as policymakers accelerate stimulative measures
- Sentiment is uniformly bearish towards China, suggesting that contrarian investors could look to benefit from cheap valuations
- In Australia, positive demographics and a watchful Reserve Bank of Australia may help curb inflation. Consumers are reducing spending and holding on to excess savings, delaying the expected slowdown

Negatives
- In China, property deleveraging remains an overarching goal which dampens domestic activity
- China consumer and business confidence are fragile, and saving is being prioritised over spending
- Australia household disposable income is falling to levels reminiscent of past recessions. Company earnings forecasts are significantly lower than other markets

Emerging Markets — N

Positives
- Monetary tightening in most emerging markets (EM) has peaked
- Equity valuations are attractive relative to the US
- Further Chinese stimulus is expected

Negatives
- Global trade could suffer with tighter monetary conditions
- Geopolitical risks remain elevated
- Chinese consumer and business confidence is fragile

U Underweight | N Neutral | O Overweight

Views are informed by the Asset Allocation Committee and regional investment committees (United Kingdom, Europe, Australia, Japan and Asia) and reflect the equity market.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 October 2023

▼ or ▲ Month-Over-Month Change

These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.

		Change	Underweight		Neutral	Overweight		
ASSET CLASSES	Equities	▲			■			Following the recent sell-off, valuations have become more reasonable amid slow global growth and higher rates. However, resilient labour markets, rising earnings estimates, overly negative sentiment and supportive fiscal policies provide reasons for optimism.
ASSET CLASSES	Fixed Income	▼			■			Yields look attractive across fixed income, and credit sectors continue to offer broadly supportive fundamentals. However, rates remain susceptible to upward pressure on lingering inflation and better-than-expected growth.
ASSET CLASSES	Cash	▼			■			Cash continues to offer attractive yield and a shorter-duration profile as rates are pressured higher, and it provides liquidity should market opportunities arise.
	Region							
EQUITIES	US					■		Earnings expectations appear to be improving, and economic activity remains resilient, with technology innovation a key differentiator. However, rising rates are pressuring companies with high interest expense and looming refinancing needs.
EQUITIES	Europe ex-UK			■				European equity valuations remain relatively attractive, headline inflation has fallen to its lowest level in over two years and the economy is showing signs of slowing, easing pressure to hike rates further. However, the eurozone economy looks to be stagnating and, with core inflation proving stubbornly elevated, the ECB policy bias remains restrictive.
EQUITIES	UK				■			Equity valuations are attractive relative to history and major peers. Core inflation has moved marginally lower, but there are signs the economy is slowing, potentially easing inflationary pressure. However, domestic factors, such as Brexit adjustments and growth in average wages, are inflationary and may keep pressure on the Bank of England to maintain rates at higher levels for a while longer.
EQUITIES	Japan					■		Japanese stocks are favoured due to the reflationary story and governance improvements. There is also upside potential from broader retail participation, due to national savings scheme changes and solid corporate buybacks. However, Japanese companies are highly leveraged to the global economy, and earnings expectations are high and rely on a weak yen. Bank of Japan policy has also turned hawkish.
EQUITIES	Developed Asia ex-Japan*				■			China economic activity is incrementally improving as policymakers accelerate stimulative efforts, especially within the property sector. However, the overarching goal of deleveraging property dampens domestic activity, and saving is still being prioritised over spending.
EQUITIES	Emerging Markets				■			Valuations and currencies are attractive, and central bank tightening may have peaked. The medium-term outlook in China has improved with economic activity incrementally improving as stimulus measures ramp up. However, business and consumer confidence remain fragile, and sentiment is universally bearish.
	Style and Market Capitalisation							
EQUITIES	Global Growth vs. Value†					■		A tilt towards higher-quality businesses is warranted given lingering economic concerns and rising rates. Momentum surrounding artificial intelligence and weight loss drugs could provide a structural tailwind to growth, although valuations are extended.
EQUITIES	Global Small-Cap vs. Large-Cap†					■		Small-caps offer attractive relative valuations but face margin concerns due to higher exposure to interest rates and higher input costs. Given heightened economic uncertainty, higher-quality bias is warranted.

Past performance is not a reliable indicator of future performance.

* Includes Australia.

† For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

The asset classes across the equity and fixed income markets shown are represented in our multi-asset portfolios. Certain style and market capitalisation asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 October 2023

▼ or ▲ Month-Over-Month Change

		Change	Underweight		Neutral	Overweight		These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.
FIXED INCOME	Euro Government Bonds			■				The ECB should continue rate hiking. Bond supply may increase due to energy compensation. High-quality duration can mitigate some risks given the decreasing likelihood of the global economy dodging a recession.
	Euro Inflation Linked	▼			■			Inflation is expected to ease further as the economy slows down. The labour market, however, remains tight, and potential rising energy prices in the winter may become inflationary.
	Euro Investment-Grade (IG) Corporates					■		Euro investment-grade credit offers good value over the short term.
	US IG Aggregate			■				After the steep rise in rates, retracement is expected. However, strong economic growth, increased bond issuance to fund the deficit and Fed policy remaining tight, may continue to put upward pressure on rates.
	Global High Yield					■		Credit fundamentals and higher yields remain supportive. Spread levels are less compelling, but default rates are likely to increase but are not expected to spike beyond long-term averages.
	EM Dollar Sovereigns					■		Yields are still attractive, while peaking central bank tightening cycles and moderating inflation are supportive. China reopening enthusiasm has faded, but modest policy support is expected.
	EM Local Currency					■		EM local valuations are fair relative to other sectors. The sector could get a boost from central banks starting to cut rates; however, impact is limited until developed market central banks' hawkish tone shifts.
	EM Corporates				■			We prefer to overweight sovereigns rather than corporates in emerging markets because credit spreads may widen as the global economy slows. We will be looking for a potential better entry point to consider overweighting EM corporates.
CURRENCIES	EUR vs. USD					■		Following the rally of the US dollar, a pullback is expected, particularly if the markets remain calm.
	EUR vs. JPY			■				The yen remains a safe-haven currency. The valuation of the yen is at attractive levels. Any further changes of policy by the Bank of Japan could support the yen.

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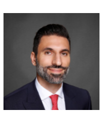
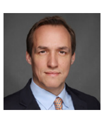
The specific securities identified and described are for informational purposes only and do not represent recommendations.

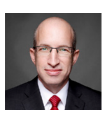
EUROPEAN INVESTMENT COMMITTEE



Elias Chrysostomou
Associate Portfolio Manager, Equity Division

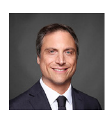


Andrew Keirle
Portfolio Manager, Emerging Markets Local Currency Bonds

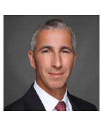


Yoram Lustig
Head of Multi-Asset Solutions, EMEA

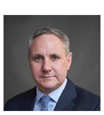
Tobias Mueller
Portfolio Manager, Equity Division



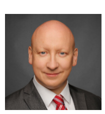
Ken Orchard
Senior Portfolio Manager, Fixed Income Division



David Stanley
Portfolio Manager, European Corporate Bonds

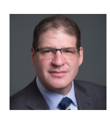


Toby Thompson
Portfolio Manager, Multi-Asset Division



Michael Walsh
Solutions Strategist, EMEA

Tomasz Wieladek
International Economist



Lowell Yura
Head of Multi-Asset Solutions, North America

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